Decision 05-10-028 October 27, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SBC California (U 1001 C) for a Surcharge and a Balancing Account to Recover Undergrounding Costs in the City of San Diego.	Application 05-03-005 (Filed March 3, 2005)

INTERIM OPINION DENYING MOTIONS TO DISMISS

I. Summary

In this decision, we deny motions to dismiss from the Office of Ratepayer Advocates (ORA) and CALTEL[1]. Based on the arguments presented, we also provide further guidance to the parties for the next phase of this proceeding.

II. Background

In January 2001, the City of San Diego (City) adopted its Underground Utilities Procedural Ordinance to provide for the expedited undergrounding of overhead utility wires within the city limits. The City's goal is to underground all currently overhead utility lines in 20 years. To accomplish this goal, the City must quadruple the current rate at which utility lines are undergrounded.

[1] For purposes of today's decision, "CALTEL" refers to the following parties acting together: XO Communications Services, Inc., MPower Communications Services, Inc., Telscape Communications, Inc., and the California Association of Competitive Telecommunications Companies.

This Commission has adopted comprehensive, statewide rules that govern when and where a utility may remove overhead lines and replace them with underground service, and whether such costs will be recovered through rates. These rules are set forth in Tariff Rule 32 for SBC California (SBC) and Tariff Rule 20 for San Diego Gas and Electric Company (SDG&E). To accommodate the City's ordinance, SDG&E sought Commission authorization to deviate from Tariff Rule 20. In Resolution E-3788, the Commission granted both SDG&E and SBC permission to deviate from their respective tariffs and comply with the City's ordinance.

To finance SDG&E's portion of the undergrounding project, the City and SDG&E entered into an agreement whereby the franchise fee SDG&E pays to the City would increase from 1.9% of gross revenues to 5.78%. Ninety percent of the increased funds would be used by the City to pay for the undergrounding. The Commission also authorized SDG&E to increase the City's franchise fee surcharge to all City customers to reflect the increased fee, and directed SBC to file an application to seek permission to recover its increased undergrounding costs from City customers.

On March 3, 2005, SBC filed this application to approve a surcharge and balancing account to track and recover its costs for the City undergrounding project.

On April 7, 2005, the Utility Consumers' Action Network (UCAN) protested the application, arguing that undergrounding costs are before the Commission in the undergrounding rulemaking (Rulemaking 00-01-005). UCAN also found SBC's cost estimates to be "shockingly high" and suggested that the proposed cost recovery might violate the New Regulatory Framework (NRF).

On May 2, 2005, XO Communications, Inc., MPower Communications Corp., and the California Association of Competitive Telephone Companies submitted their late-filed protest, along with a motion seeking leave to file it, and argued that SBC is already being compensated for undergrounding costs pursuant to rates set under the NRF.

On April 18, 2005, the ORA filed a motion requesting permission to late-file its protest to this application, which was granted on May 3, 2005. ORA also challenged the requested relief as violating NRF principles.

On April 29, 2005, Telscape Communications, Inc. (Telscape) filed a motion seeking permission to late-file its protest to the application, with the protest attached. In its protest, Telescape stated that SBC-California proposes to place a surcharge on the fees Telscape pays to lease unbundled basic loops from SBC. Telscape contended that such a surcharge violates federal law, and that undergrounding costs must be allocated between regulated and unregulated services. ORA and a coalition of the competitive carriers (CALTEL, see footnote 1) filed motions to dismiss, and SBC and the City responded. CALTEL also filed a reply.

On May 24, 2005, the assigned Administrative Law Judge (ALJ) convened a prehearing conference. To resolve the threshold issues of whether the Commission was prohibited by federal law or NRF from approving the proposed surcharge, a schedule was set to consider the motions to dismiss. This decision resolves the motions to dismiss.

III. Positions of the Parties

A. ORA

In its motion, ORA concedes that the Commission has the authority to grant SBC's request for a surcharge and balancing account. ORA, however,

reviews NRF history and principles, and concludes that the Commission should not do so. ORA explains that the basic premise of NRF is that utilities bear the risk of poor business decisions but also retain the benefits of efficient management. NRF utilities, such as SBC, are not subject to traditional cost of service ratemaking but rather the Commission sets a price cap and the utility must manage its costs. At one time, a NRF utility could seek a rate change for unforeseen expenses, referred to as "exogenous costs." The Commission, however, has suspended such cost recovery and insisted that NRF utilities bear the risk of such cost increases, just as they reap the rewards of any cost decreases or productivity improvements. ORA concludes that surcharges and balancing accounts are simply incompatible with NRF.

Turning to the specific costs SBC seeks to recover, ORA contends that undergrounding costs are ordinary, controllable business costs that are the shareholders' responsibility under NRF. ORA points out that SBC management executed an agreement with the City whereby SBC is under no obligation to underground its lines unless the Commission grants the requested surcharge. ORA also noted that the City newspaper accused SBC of "holding the undergrounding project hostage until it gets its way."

ORA further explains that NRF rates include an assumed level of undergrounding, and that to the extent the Commission allows SBC to recover these costs through a surcharge, SBC will be recovering the same costs twice, "double-dipping." ORA concludes that NRF prohibits such dual cost recovery.

B. CALTEL

CALTEL states that SBC's proposed surcharge on lines served by competitive local exchange carriers in the City violates federal law, and that changing the price these carriers pay by adding a surcharge would be

procedurally unlawful. CALTEL explains that the price at which it purchases unbundled loops from SBC is set by a detailed methodology adopted by the Federal Communications Commission (FCC). That methodology, total element long-run incremental cost, rejects actual cost of service and instead substitutes a hypothetical least-cost, most efficient network. In support, CALTEL points to 47 U.S.C. § 252(d)(1) which prohibits state commissions from setting prices for network elements by "reference to a rate-of-return or other rate-based proceeding." In contrast to federal law, CALTEL argues, SBC seeks to recover its actual costs of making changes to the City's network. CALTEL concludes that recovery of such costs through charges for unbundled network elements is prohibited by the FCC's rules, and that the application should be dismissed.

CALTEL also argues that SBC's proposed change in the price that competitive local exchange carriers would pay for network elements requires notice and an opportunity to be heard to all parties that participated in the Commission's proceeding setting the network element prices.

CALTEL next challenges SBC's entire proposed surcharge, not just as applied to competitive local exchange carriers, as violating both "the spirit and the text" of prior Commission decisions creating NRF. Like ORA, CALTEL argues that under NRF, SBC bears both the risk of increased costs, such as undergrounding, and the benefits of cost reductions and enhanced efficiency.

C. SBC

In opposition to the motions to dismiss, SBC argues that neither NRF nor federal law precluded the Commission from approving the requested surcharge. SBC emphasizes that the decision to underground utility lines in the City was made by the duly elected representatives of San Diego, and that this

extraordinary project will result in an unprecedented plant structure, i.e., all facilities underground.

SBC concedes that NRF places the risks of business and operating decisions on SBC's shareholders, but contends that the City's undergrounding program was not a decision of SBC's management. SBC required special permission from this Commission to deviate from approved tariffs and participate in the City's requested level of undergrounding. SBC concludes that its shareholders should not bear the burden of this unprecedented level of undergrounding expenditures.

SBC also argues that federal telecommunications law does not prohibit the Commission from approving the requested surcharge. SBC explains that its application "does not seek to change the UNE loop rate or otherwise modify the rates adopted in D.04-09-063. Rather, it seeks to impose a temporary surcharge on the telephone bill of San Diego customers (both retail and wholesale) in order to recover the costs of placing existing aerial loops in San Diego underground." SBC states that federal pricing rules do not prohibit recovery of all actual costs, and that the Commission relied on SBC's actual incurred costs for certain components of the network element price, such as actual vendor contracts for switching and cable price inputs.

D. City Of San Diego

The City supported SBC's request for the surcharge to the extent such costs have not been recovered or booked for recovery and are legitimate expenses, but no more. The City also contends that its undergrounding program is unique and was not contemplated by the Commission when implementing NRF regulations.

IV. Discussion

Rule 56 of the Commission's Rules of Practice and Procedure provides a party the right to file a motion to dismiss any proceeding before the Commission. Pursuant to the schedule set at the prehearing conference, CALTEL submitted its motion to dismiss the application based on federal telecommunications law and NRF. ORA's motion to dismiss is based on NRF.

To grant a Rule 56 motion to dismiss, the Commission must determine that there are no triable issues of material fact and the moving party is entitled to judgment as a matter of law. Westcom Long Distance, Inc., v. Pacific Bell, 54 CPUC 2d 244, 249 (D.94-04-082). The parties agree that there are no triable issues of material fact necessary to resolve these motions. In today's decision, we determine that ORA and CALTEL have failed to demonstrate that they are entitled to judgment as a matter of law.

A. New Regulatory Framework

When this Commission created NRF in 1989, we provided for comprehensive review and modifications on a three-year cycle (D.89-10-031, 33 CPUC 43, 236). Since that time, we have adopted various revisions to NRF (see D.02-10-020). Neither ORA nor CALTEL have provided a citation to a Commission decision addressing the issue before us now, namely, whether a surcharge to collect extraordinary undergrounding costs is consistent with NRF. Both parties presented coherent arguments that extrapolated from past indications of Commission NRF policy. The standard for granting a motion to dismiss, however, requires that the party be entitled to judgment as a matter of law. Here, the Commission has retained supervision and jurisdiction of the NRF program, and implemented regular modifications, but has not addressed the question of extraordinary undergrounding costs. Consequently, the moving

parties can not demonstrate that they are entitled to judgment in their favor as a matter of law.

Our holding today is limited. In the substantive phase of this proceeding, we will carefully review SBC's proposal in light of NRF, as modified over the years, and other Commission law and policies. We have not pre-judged the outcome of this review. We may ultimately decide that SBC's proposed surcharge is not consistent with the NRF or other Commission policies. Today's decision holds only that, as a matter of law, this Commission may consider SBC's proposal.

B. Federal Telecommunications Law

We are similarly without precedent squarely on point with regard to CALTEL's motion based on federal telecommunications law. As discussed below, however, Congress retained local authority to "manage" rights-of-way, which the City has exercised with its ordinance requiring undergrounding. SBC now proposes a Commission-approved surcharge on each telephone line in San Diego to recover the costs of complying with the ordinance in a competitively neutral manner. We are not persuaded that Congress clearly intended to preclude such a surcharge as a matter of law, and we therefore deny CALTEL's motion to dismiss the application.

CALTEL relies primarily on federal law and FCC regulations describing the methodology for setting prices for the network elements as the basis for its assertion that the Commission is precluded from adopting SBC's proposed surcharge. The pricing methodology, however, does not specifically address extraordinary undergrounding costs, either to specifically include or exclude these costs.

CALTEL argues that the proposed surcharge on unbundled loop rates is irreconcilably inconsistent with the FCC's mandatory pricing rule. CALTEL states that the FCC's pricing rule rejects actual costs in favor of a hypothetical most efficient, least cost system on which to calculate rates, and this rule preempts this Commission from adopting any other rule. Because SBC's proposed surcharge is based on actual costs, CALTEL concludes that the surcharge violates the pricing rule and entitles CALTEL to a ruling in its favor as a matter of law. Specifically, CALTEL cites to 47 U.S.C. § 252 (d)(1)(A) of the 1996 Federal Telecommunications Act which states that the rates of network elements shall be based on cost "determined without reference to rate-of-return or other rate-based proceeding."

CALTEL is correct that this statute limits the authority of this Commission in setting only "the just and reasonable rate for the interconnection of facilities . . . and network elements." This Commission set those rates in D.04-09-063. At issue in this proceeding, in contrast, is a collection mechanism for extraordinary undergrounding costs imposed by the City.

In the Resolution allowing SDG&E and SBC to deviate from their tariff rules which would preclude the undergrounding pace mandated by the City, this Commission specifically declined to review or second guess the City's decision:

> Elected officials in city government, representing the citizens of the City, following public notice and hearings, decided additional revenues were needed to fund an underground conversion program beyond that funded through SDG&E's base rates. The City has determined that the program is in the public interest and we should not second-guess that decision.

In a typical rate case, this Commission determines whether costs incurred by the utility are "just and reasonable." Here, however, the decision to impose the costs has been made by the City, a decision we will respect. Indeed, we have accommodated the City's decision by allowing both SDG&E and SBC to deviate from their otherwise applicable undergrounding rules which are at odds with the City's program.

SBC has now put forward a competitively neutral mechanism[2] to recover its costs of complying with the City's program. Under SBC's proposal, each telephone line in the City, whether served by SBC or its competitors, will bear an equal share of the costs. CALTEL argues that federal law preempts this Commission from approving SBC's proposed surcharge to the extent it would be applied to competitive local carriers. Our review of federal law reveals no support for CALTEL's assertion that it is entitled to judgment in its favor as a matter of law.

Federal preemption of state telecommunications law must be "clear," and the state action must "flagrantly and patently" violate the Constitution:

> The United States Supreme Court and the Ninth Circuit have held that federal preemption of state regulation in the area of telecommunications must be clear and occurs only in limited circumstances. . . . [S]tate action may be preempted only for conduct that is "flagrantly and patently" violative of the Constitution, i.e., preemption must be "readily apparent."

[2] For purposes of today's decision, we accept SBC's representation that its proposed surcharge is, in fact, competitively neutral. Any allegations that it is not can be resolved in the substantive phase of this proceeding.

Communications Telesystems International v. CPUC, 196 F.3d 1011, 1017 (9th Cir. 1999).

Rather than "clearly" preempting state and local authority over undergrounding, Congress explicitly retained such authority. In San Diego, as in most cities, utility lines are largely placed in the public right-of-way, i.e. along or under the public streets. Local governments, here, the City of San Diego, own and manage the public rights of way. Congress specifically retained full state and local authority over rights-of-way in 47 U.S.C. § 253(c):

> Nothing in this section affects the authority of State and local government to manage the public rights-of-way or to require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis, for use of the public rights-of-way on a nondiscriminatory basis.

The City has decided to "manage" its rights-of-way[3] such that all utility lines must be undergrounded. SBC will incur costs to comply with the City's directive, and seeks to recover those costs from San Diego customers with a competitively neutral surcharge.

Numerous surcharges are currently placed on telecommunications service bills for a variety of different purposes. One bill from a competitive local carrier included the following:

1. California Relay Service and Commission Devices Funds (Deaf and Disabled Telecommunications Program)

[3] Federal law imposes no legal impediment to the City of San Diego directly imposing an undergrounding fee on all telephone service providers using the San Diego rights-of way. See TCG New York, Inc., v. White Plains, 305 F.3d 67, 77-81 (2nd Cir. 2002). If the City can directly impose the same type of fee that SBC's proposes, then CALTEL's quarrel with the proposal appears to be one of form rather than substance.

2. Universal Lifeline Service
3. California High Cost Fund, A & B
4. Public Utility Commission Fee
5. California Teleconnect Fund
6. 9-1-1 Surcharge

These surcharges are not included in revenue requirement for ratemaking purposes, but rather are treated as separate cost recovery items. The amounts collected from these surcharges fund various programs, such as low-income telephone service discounts (universal service), and discounts for schools and hospitals (Teleconnect Fund). These surcharges are not subject to the FCC's cost methodology, and remain in place. CALTEL provides no persuasive analysis demonstrating that Congress, while allowing these surcharges, "clearly" intended to preempt a San Diego surcharge for extraordinary undergrounding[4] costs.

In sum, Congress retained local authority to "manage" rights-of-way, and consistent with this authority, the City has adopted a valid ordinance requiring the undergrounding of utility lines. With the City's support, SBC has proposed a Commission-approved surcharge on each telephone line in the City to recover the costs of complying with the ordinance in a competitively neutral manner. CALTEL has not shown that Congress clearly intended to exclude extraordinary undergrounding costs from recovery via a surcharge. Consequently, CALTEL

[4] "Ordinary" undergrounding costs, however, would appear to be included in network element revenue requirement and thus would be subject to the FCC's methodology. As discussed later in today's decision, the primary issue for next phase of this proceeding will be to determine which, if any, of SBC's undergrounding costs are extraordinary.

has not demonstrated that it is entitled to judgment in its favor as a matter of law, and we must deny its motion to dismiss the application.

V. Costs to be included in the Surcharge

Although we conclude that the moving parties have not met their burden of showing that they are entitled to judgment in their favor as a matter of law, the parties have raised valid objections to including certain cost elements in the surcharge calculations. The assigned Commissioner and ALJ should manage this proceeding to ensure that a full factual and legal record is created for our consideration on these, and any other, issues.

As ORA and CALTEL correctly note, undergrounding costs are included in both the NRF and network element revenue requirements. SBC's tariff Rule 32 sets forth a specific program, including eligibility requirements and cost allocations, for undergrounding SBC's lines. These are ordinary and expected costs. The substantive phase of this proceeding should carefully review these costs to determine the additional increment necessary to comply with the City's ordinance.

Telscape also raised the issue of SBC providing its own unregulated services using the lines in San Diego. Telscape contended that SBC's undergrounding costs should be allocated between SBC's regulated and unregulated services, with only the regulated "extraordinary" share used to determine any surcharge for competitive local carriers. This issue should also be explored and resolved in the substantive phase of this proceeding.

SBC may also realize cost savings from having the lines underground. Any such savings should be analyzed, quantified, and used as an offset to the costs SBC proposes to pass along to San Diego residents.

Finally, we agree with the parties that on-going accounting and cost allocation oversight of this program is essential.

While detailed cost studies would be necessary to evaluate each work element proposed to be recorded in the balancing account, such studies are often controversial and can lead to a lengthy hearing process. We encourage the parties to consider informal clarification of data upon which the studies will be based, cooperative development of the studies, and any other form of joint fact-finding that might expedite the hearing process. We also encourage the parties to consider Alternative Dispute Resolution methods as a means to resolve this application.

VI. Need for Hearings

As there are no disputed issues of material fact necessary to resolve the motions, no evidentiary hearings are necessary.

VII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Maribeth Bushey is the assigned ALJ in this proceeding.

VIII. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on the draft decision by SBC, the City of San Diego, XO Communications Services, Inc., and, jointly, MPower Communications Corporation, Telscape Communications, and the California Association of Competitive Telecommunications Companies (Joint Commenters).

SBC supported the outcome of the draft decision but took issue with Section V which contains general observations on cost issues that will need to be

addressed in the substantive phase of the proceeding. SBC's comments are premature but should be fully considered in the substantive phase.

The City also supported the outcome, and added that it considered a utility use tax, but decided, based on Resolution E-3788, extensive mediation, and public review, that the proposed surcharge was a better alternative. The City also asked that a scoping memo be included in the decision. We decline to do so at this time. Consistent with our rules, we will leave this important procedural step to the Assigned Commissioner and ALJ.

XO Communications opposed the outcome of the decision and supported the comments submitted by the Joint Commenters. XO's comments raised policy issues regarding the wisdom of Commission allowing its general ratemaking authority to be used by the City as a mechanism to collect the costs of undergrounding utility lines. XO first observed that undergrounding utility lines is extremely expensive. With the proposed surcharge, San Diego residents will be paying an extra $4 per month in utility charges ($3 to SDG&E and $1 to SBC), on top of anticipated sharp increases in the price of natural gas. XO next presented a recitation of the Commission's historic role in balancing the costs of undergrounding with the benefits. XO concluded that the Commission had unwisely ceded control of utility undergrounding to cities. XO also noted that the oversight needed for SBC's proposed surcharge will impose a significant burden on Commission staff.

The Joint Commenters called the draft decision's conclusion that federal law did not prohibit the proposed surcharge "simply absurd" because the surcharge does not comply with the FCC pricing rules. They also contended that public purpose surcharges, unlike SBC's proposed surcharge, are collected from customers, and not assessed on unbundled loops.

Reply comments were filed by ORA, XO, SBC, Joint Commenters, and the City. ORA opposed SBC's and the City's proposed modifications to the draft decision because such modifications were not based on factual, legal, or technical errors but were rather factual distortions to serve the City's ends.

The Joint Commenters contended that the City admitted that the realities of San Diego politics would have precluded the City from imposing a competitively neutral surcharge, and therefore the Commission cannot act as a surrogate for the City in levying this surcharge.

SBC argued that the competitive providers had failed to show legal error in the draft decision. SBC agreed that XO raised "valid public policy concerns with permitting cities to require undergrounding facilities," but that XO had failed to identify any legal error as a basis for overturning the draft decision.

The City stated the XO's comments were improper because the comments were not limited to "factual, legal, or technical errors" in the draft decision. The City contended that the issues raised by XO have been debated and resolved by the Commission and the State Legislature.

On the whole, the comments raised issues more appropriately resolved in the substantive phase or reargued previously articulated positions. No substantive changes have been made to the draft decision. XO's comments, coupled with SBC's insistence on "full cost recovery," raise additional issues that will be addressed in the substantive phase of this proceeding.

Findings of Fact

1. ORA and CALTEL filed motions to dismiss the application.

2. There are no disputed issues of material fact related to the motions to dismiss.

3. Numerous surcharges for items not included in revenue requirement appear on competitive local carriers' telephone bills.

Conclusions of Law

1. The Commission authorized SBC to deviate from its tariff Rule 32 and to implement a higher rate of undergrounding in the City.

2. The Commission retains full jurisdiction over NRF and may make any necessary modifications.

3. As a matter of law, NRF does not preclude granting SBC's requested relief.

4. As a matter of law, this Commission may consider SBC's proposal.

5. Preemption of state telecommunications law by federal law must be "clear."

6. As set out in 47 U.S.C. §253(c) of the 1996 Federal Telecommunications Act, Congress did not intend to preempt local authorities' right to "manage" their rights of way.

7. Surcharges for various public purposes are included on competitive local carriers' bills.

8. CALTEL has not shown clear evidence that Congress intended federal telecommunications law and regulations to preclude granting SBC's requested surcharge for extraordinary undergrounding costs.

9. ORA and CALTEL have not demonstrated that they are entitled to judgment in their favor as a matter of law.

10. ORA's and CALTEL's motions to dismiss should be denied.

11. This decision should be effective immediately.

INTERIM ORDER

IT IS ORDERED that the motions to dismiss submitted by the Office of Ratepayer Advocates and, jointly by, XO Communications Services, Inc.,

MPower Communications Services, Inc., Telscape Communications, Inc, and the California Association of Competitive Telecommunications Companies are denied.

This order is effective today.

Dated October 27, 2005, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
DIAN M. GRUENEICH
JOHN A. BOHN
Commissioners